

Texas Roadhouse, Inc.
Form 10-K
February 25, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the fiscal year ended December 25, 2007

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Texas Roadhouse, Inc.

(Exact name of registrant specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

000-50972
(Commission File Number)

20-1083890
(IRS Employer Identification Number)

**6040 Dutchmans Lane, Suite 200
Louisville, Kentucky 40205**
(Address of principal executive offices) (Zip Code)

(502) 426-9984
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Class A Common Stock, par value \$0.001 per share

Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No .

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes No .

Indicate by check mark whether registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K. .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No .

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last day of the second fiscal quarter ended June 26, 2007 was \$662,456,263 based on the closing stock price of \$12.65. Shares of voting stock held by each officer and director and by each person who owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. The registrant has no shares of non-voting common stock authorized or outstanding. The market value calculation was determined using the closing stock price of our Class A common stock on the Nasdaq Global Select Market.

The number of shares of Class A and Class B common stock outstanding were 69,639,963 and 5,265,376, respectively, on February 15, 2008.

Portions of the registrant's definitive Proxy Statement for the registrant's 2008 Annual Meeting of Stockholders, which is expected to be filed pursuant to Regulation 14A within 120 days of the registrant's fiscal year ended December 25, 2007, are incorporated by reference into Part III of the Form 10-K. With the exception of the portions of the Proxy Statement expressly incorporated by reference, such document shall not be deemed filed with this Form 10-K.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains statements about future events and expectations that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are based on our beliefs, assumptions and expectations of our future financial and operating performance and growth plans, taking into account the information currently available to us. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the expectations of future results we express or imply in any forward-looking statements. In addition to the other factors discussed under "Risk Factors" elsewhere in this report, factors that could contribute to these differences include, but are not limited to:

our ability to raise capital in the future;

our ability to successfully execute our growth strategy;

our ability to successfully open new restaurants, acquire franchise restaurants or execute other strategic transactions;

our ability to integrate the franchise or other restaurants which we acquire or develop;

the continued service of key management personnel;

health concerns about our food products;

our ability to attract, motivate and retain qualified employees;

the impact of federal, state or local government regulations relating to our employees or production and the sale of food and alcoholic beverages;

the impact of litigation;

the cost of our principal food products;

labor shortages or increased labor costs;

inflationary increases in the costs of construction and real estate;

changes in consumer preferences and demographic trends;

increasing competition in the restaurant industry;

our ability to successfully expand into new domestic and international markets;

the rate of growth of general and administrative expenses associated with building a strengthened corporate infrastructure to support our growth initiatives;

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negative publicity regarding food safety, health concerns and other food or beverage related matters;

our franchisees' adherence to our practices, policies and procedures;

potential fluctuation in our quarterly operating results due to seasonality and other factors;

supply and delivery shortages or interruptions;

inadequate protection of our intellectual property;

volatility of actuarially determined insurance losses and loss estimates;

adoption of new, or changes in existing, accounting policies and practices;

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adverse weather conditions which impact guest traffic at our restaurants; and

adverse economic conditions.

The words "believe," "may," "should," "anticipate," "estimate," "expect," "intend," "objective," "seek," "plan," "strive" or similar words, or the negatives of these words, identify forward-looking statements. We qualify any forward-looking statements entirely by these cautionary factors.

Other risks, uncertainties and factors, including those discussed under "Risk Factors," could cause our actual results to differ materially from those projected in any forward-looking statements we make.

We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I

ITEM 1 BUSINESS

Texas Roadhouse, Inc. ("Texas Roadhouse" or the "Company") was incorporated under the laws of the state of Delaware in 2004. From April 1, 1997 through October 8, 2004, the business of the Company was conducted by Texas Roadhouse Holdings LLC ("Holdings") and its affiliates. On October 8, 2004, Holdings and its wholly-owned and majority-owned affiliates completed a reorganization and initial public offering. In connection with the reorganization and public offering, Holdings became a subsidiary of the Company. The principal executive office is located in Louisville, Kentucky.

General Development of Business

Texas Roadhouse is a growing, moderately priced, full-service, casual dining restaurant chain. Our founder and chairman, W. Kent Taylor, started the business in 1993. Our mission statement is "Legendary Food, Legendary Service®." Our operating strategy is designed to position each of our restaurants as the local hometown destination for a broad segment of consumers seeking high quality, affordable meals served with friendly, attentive service. As of December 25, 2007, there were 285 Texas Roadhouse restaurants operating in 44 states. We owned and operated 204 restaurants in 39 states and franchised and licensed an additional 81 restaurants in 23 states.

Over the past five years, the total number of Texas Roadhouse company and franchise restaurants increased from 142 restaurants as of the end of 2002 to 285 restaurants as of the end of 2007, representing a 15.0% compounded annual growth rate. Over the same period, our revenue increased from \$232.8 million to \$735.1 million, our income from operations increased from \$26.3 million to \$63.2 million, and our net income increased from \$17.0 million to \$39.3 million, representing compounded annual growth rates of 25.9%, 19.2% and 18.3%, respectively.

Financial Information about Operating Segments

As of December 25, 2007, we operated 204 Texas Roadhouse restaurants, each as a single operating segment, and franchised and licensed an additional 81 restaurants. The restaurants operate exclusively in the U.S. within the casual dining segment of the restaurant industry, providing similar products to similar customers. The restaurants also possess similar pricing structures, resulting in similar long-term expected financial performance characteristics. We consider our restaurant and franchising operations as similar and have aggregated them into a single reportable segment.

Narrative Description of Business

Texas Roadhouse is a full-service, casual dining restaurant chain. We offer an assortment of specially seasoned and aged steaks hand-cut daily on the premises and cooked to order over open gas-fired grills. In addition to steaks, we also offer our guests a selection of ribs, fish, seafood, chicken, pork chops and vegetable plates, and an assortment of hamburgers, salads and sandwiches. The majority of our entrées include two made-from-scratch side items, and we offer all our guests a free unlimited supply of roasted in-shell peanuts and made-from-scratch yeast rolls.

The operating strategy that underlies the growth of our concept is built on the following key components:

Offering performance-based manager compensation. We offer a performance-based compensation program to our restaurant managers and area managers, who are called "managing partners" and "market partners," respectively. Each of these partners earns a base salary plus a performance bonus, which represents a percentage of their respective restaurant's pre-tax net income. By providing our partners with a significant stake in the success of our restaurants, we

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believe that we are able to attract and retain talented, experienced and highly motivated managing and market partners.

Offering high quality, freshly prepared food. We place a great deal of emphasis on ensuring our guests receive high quality, freshly prepared food. We have developed proprietary recipes to provide consistency in quality and taste throughout all restaurants. We expect a management level employee to inspect every entrée before it leaves the kitchen to confirm it matches the guest's order and meets our standards for quality, appearance and presentation. In addition, we employ a team of product coaches whose sole function is to provide continual, hands-on training and education to our kitchen staff for the purpose of assuring uniform adherence to recipes, food preparation procedures, food safety standards, food appearance, freshness and portion size.

Focusing on dinner. In a high percentage of our restaurants, we limit our operating hours to dinner only during the weekdays. By focusing on dinner, our restaurant teams have to prepare for and manage only one shift per day during the week. We believe this allows our restaurant teams to offer higher quality, more consistent food and service to our guests. We believe the dinner focus provides a better "quality-of-life" for our management teams and, therefore, is a key ingredient in attracting and retaining talented and experienced management personnel. We also focus on keeping our table-to-server ratios low to allow our servers to truly focus on their guests and serve their needs in a personal, individualized manner.

Offering attractive price points. We offer our food and beverages at moderate price points that are as low as or lower than those offered by many of our competitors. Within each menu category, we offer a choice of several price points with the goal of fulfilling each guest's budget and value expectations. For example, our steak entrées, which include the choice of two side items, generally range from \$8.99 for our 6-ounce sirloin to \$19.99 for our 18-ounce T-bone. The per guest average check for the restaurants we owned and operated in 2007 was approximately \$14.75. Per person average check represents restaurant sales divided by the number of guests served. We considered each sale of an entrée to be a single guest served. Our per guest average check is highly influenced by our weekday dinner only focus.

Creating a fun and comfortable atmosphere. We believe the atmosphere we establish in our restaurants is a key component for fostering repeat business. Our restaurants feature a rustic southwestern lodge décor accentuated with hand-painted murals, neon signs, and southwestern prints, rugs and artifacts. Additionally, we offer jukeboxes, which continuously play upbeat country hits, and in-house entertainment such as line dancing and birthday celebrations.

Unit Prototype and Economics

We designed our prototype Texas Roadhouse restaurant to provide a relaxed atmosphere and maximize restaurant sales. The Texas Roadhouse prototypical restaurant consists of a freestanding building with approximately 6,300 to 7,200 square feet of space constructed on sites of approximately 1.7 to 2.0 acres, with seating at approximately 56 tables for a total of 239 guests, including 15 bar seats, and parking for approximately 150 automobiles. Our current prototype is adaptable to in-line locations such as spaces within an enclosed mall or a shopping center.

The total cash cost of developing the current prototype Texas Roadhouse restaurant in which we own the land is approximately \$3.5 to \$4.5 million or \$3.1 to \$4.1 million excluding pre-opening costs. This cost includes approximately \$0.7 million to \$1.5 million for land, approximately \$1.2 million to \$1.8 million for building and site construction, approximately \$0.8 million for furniture, fixtures, signage and equipment and approximately \$0.4 million for pre-opening costs. When we lease the land, the total cash cost of developing our prototype restaurant is between \$2.5 million and \$3.5 million including pre-opening costs or \$2.0 to \$2.6 million excluding pre-opening costs. As of December 25, 2007, we owned 110 properties and leased 94 properties.

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Our average unit volume for 2007 was \$4.0 million. The time required for a new restaurant to reach a steady level of cash flow is approximately three to six months.

Site Selection

We continue to develop and refine our site selection process. In analyzing each prospective site, management devotes significant time and resources to the evaluation of local market demographics, population density, household income levels and site-specific characteristics such as visibility, accessibility, traffic generators, proximity of other retail activities, traffic counts and parking. Our management works actively with real estate brokers in target markets to select high quality sites and to maintain and regularly update our database of potential sites. Management typically requires three to six months to locate, approve and control a restaurant site and typically four to eight additional months to obtain necessary permits. Upon receipt of permits, it requires approximately four months to construct, equip and open a restaurant.

Existing Restaurant Locations

As of December 25, 2007, we had 204 company restaurants and 81 franchise restaurants in 44 states as shown in the chart below.

| | Number of Restaurants | | |
|----------------|-----------------------|-----------|-------|
| | Company | Franchise | Total |
| Alabama | 3 | | 3 |
| Arizona | 7 | | 7 |
| Arkansas | 1 | | 1 |
| California | | 3 | 3 |
| Colorado | 11 | 1 | 12 |
| Connecticut | 3 | | 3 |
| Delaware | 2 | | 2 |
| Florida | 2 | 5 | 7 |
| Georgia | 2 | 7 | 9 |
| Idaho | 3 | | 3 |
| Illinois | 6 | 2 | 8 |
| Indiana | 11 | 8 | 19 |
| Iowa | 5 | | 5 |
| Kansas | 2 | 1 | 3 |
| Kentucky | 6 | 3 | 9 |
| Louisiana | 5 | 1 | 6 |
| Maine | 1 | | 1 |
| Maryland | 1 | 4 | 5 |
| Massachusetts | 5 | 1 | 6 |
| Michigan | 7 | 3 | 10 |
| Minnesota | 1 | | 1 |
| Mississippi | 1 | | 1 |
| Missouri | 3 | 2 | 5 |
| Montana | | 1 | 1 |
| Nebraska | | 1 | 1 |
| New Hampshire | 2 | | 2 |
| New Jersey | 1 | | 1 |
| New Mexico | 2 | | 2 |
| New York | 4 | | 4 |
| North Carolina | 11 | | 11 |

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| | | | |
|----------------|------------|-----------|------------|
| North Dakota | 2 | 1 | 3 |
| Ohio | 14 | 4 | 18 |
| Oklahoma | 5 | | 5 |
| Pennsylvania | 12 | 5 | 17 |
| Rhode Island | 1 | | 1 |
| South Carolina | | 6 | 6 |
| South Dakota | 1 | | 1 |
| Tennessee | | 13 | 13 |
| Texas | 41 | 4 | 45 |
| Utah | 4 | | 4 |
| Virginia | 7 | | 7 |
| West Virginia | 1 | 2 | 3 |
| Wisconsin | 7 | 3 | 10 |
| Wyoming | 1 | | 1 |
| | <hr/> | <hr/> | <hr/> |
| Total | 204 | 81 | 285 |
| | <hr/> | <hr/> | <hr/> |

Food

Menu. Texas Roadhouse restaurants offer a wide variety of menu items at attractive prices that are designed to appeal to a broad range of consumer tastes. Our dinner entrée prices generally range from \$7.99 to \$19.99. We offer a broad assortment of specially seasoned and aged steaks, including 6, 8, 11 and 16 oz. Sirloins; 10, 12 and 16 oz. Rib-eyes; 6 and 8 oz. Filets; Prime Rib; and T-Bones, most of which are hand-cut daily on the premises and cooked over open gas-fired grills. We also offer our guests a selection of fish, seafood, chicken, pork chops, ribs and vegetable plates, and an assortment of hamburgers, salads and sandwiches. Entrée prices include made-from-scratch yeast rolls and most include two of the following made-from-scratch sides: baked potato, sweet potato, steak fries, mashed potatoes, house or Caesar salad, green beans, chili, seasoned rice, baked beans and steamed vegetables. Our menu allows guests to customize their meals by ordering steaks that are "smothered" either in cheese, onions, gravy or mushrooms and baked potatoes "loaded" with cheese and bacon. Other menu items include specialty appetizers such as the "Cactus Blossom®" and "Chicken Critters®" (chicken tenders). We also provide a "12 & Under" menu for children that includes a sirloin steak, rib basket, Jr. Chicken Critters, cheeseburger, hot dog and macaroni and cheese, all served with a beverage at prices generally between \$2.99 and \$6.99.

Most of our restaurants feature a full bar that offers an extensive selection of draft and bottled beer. Managing partners are encouraged to tailor their beer selection to include regional brands and microbrews. We serve a selection of major brands of liquor and wine as well as frozen margaritas. Alcoholic beverages accounted for 11.4% of restaurant sales at Texas Roadhouse in fiscal 2007.

We have maintained a consistent menu over time, with a selection of approximately 60 menu items. We continually review our menu to consider enhancements to existing menu items or the introduction of new items. We change our menu only after guest feedback and an extensive study of the operational and economic implications. To maintain our high levels of food quality and service, we generally remove one menu item for every new menu item introduced so as to facilitate our ability to execute high quality meals on a focused range of menu items.

Food Quality. We are committed to serving a varied menu of high-quality, great tasting food items with an emphasis on freshness. We have developed proprietary recipes to ensure consistency in quality and taste throughout all restaurants and provide a unique flavor experience to our guests. At each restaurant, a fully trained meat cutter hand cuts our steaks and other restaurant team members prepare

all side items and yeast rolls from scratch in the restaurants daily. We assign individual kitchen employees to the preparation of designated food items in order to focus on quality, consistency and speed. Additionally, we expect a management level employee to inspect every entrée before it leaves the kitchen to confirm it matches the guest's order and meets our standards for quality, appearance and presentation.

We employ a team of product coaches whose sole function is to provide continual, hands-on training and education to the kitchen staff in all Texas Roadhouse restaurants for the purpose of assuring uniform adherence to recipes, food preparation procedures, food safety standards, food appearance, freshness and portion size. The team currently consists of over 25 product coaches, each handling an average of ten restaurants system-wide. We expect to maintain a comparable ratio of product coaches to restaurants as we continue to grow.

Purchasing. Our purchasing philosophy is designed to consistently supply fresh, quality products to the restaurants at competitive prices while maximizing operating efficiencies. We negotiate directly with suppliers for substantially all food and beverage products to ensure consistent quality and freshness and obtain competitive prices. Certain products, such as dairy products and select produce, are purchased locally to assure freshness.

Food and supplies are ordered by, and shipped directly to, the restaurants, as we do not maintain a central product warehouse or commissary. Most food products used in the operation of our restaurants are distributed to individual restaurants through an independent national distribution company. We strive to qualify more than one supplier for all key food items and believe that beef of comparable quality as well as all other essential food and beverage products are available, upon short notice, from alternative qualified suppliers.

Food Safety. Food safety is of utmost importance to Texas Roadhouse. We currently employ several programs to ensure adherence to proper food preparation procedures and food safety standards. Texas Roadhouse has an established Quality Assurance department whose function is to develop, enforce and maintain programs designed to ensure strict adherence to food safety guidelines. Where required, food items purchased from qualified vendors have been inspected by reputable, outside inspection services confirming that the vendor is compliant with FDA and USDA guidelines.

Each product coach is required to perform a sanitation audit on two restaurants each month and send the results to our Quality Assurance/Food Safety department for review. To reinforce the importance of food safety, Texas Roadhouse has printed all HAACP (Hazard Analysis and Critical Points) in bold type on each recipe. In addition, several of our product coaches have obtained or are in the process of obtaining their food safety professional designation.

Service

Guest Satisfaction. Through the use of guest surveys, our website "texasroadhouse.com," a toll-free guest response telephone line and personal interaction in the restaurant, we receive valuable feedback from guests. Additionally, we employ an outside service to administer a "Secret Shopper" program whereby trained individuals periodically dine and comprehensively evaluate the guest experience at each of our restaurants. Particular attention is given to food and service quality, cleanliness, staff attitude and teamwork, and manager visibility and interaction. The resulting reports are used for follow up training feedback to both staff and management.

Atmosphere. The atmosphere of Texas Roadhouse restaurants is intended to appeal to broad segments of the population, children, families, couples, adults and business persons. Substantially all Texas Roadhouse restaurants are of our prototype design, reflecting a rustic southwestern lodge atmosphere, featuring an exterior of rough-hewn cedar siding and corrugated metal. The interiors feature pine floors and stained concrete and are decorated with hand-painted murals, neon signs,

southwestern prints, rugs and artifacts. The restaurants contain jukeboxes that continuously play upbeat country hits. Guests may also view a display-cooking grill and a meat cooler displaying fresh cut steaks, and may wait for seating in either a spacious, comfortable waiting area or a southwestern style bar. While waiting for a table, guests can enjoy complimentary roasted in-shell peanuts and watch as cooks prepare steaks and other entrées on the gas-fired grills. Immediately upon being seated at a table, guests can enjoy made-from-scratch yeast rolls along with roasted in-shell peanuts.

People

Management and Employees. Each of our restaurants is generally staffed with one managing partner, one kitchen manager and one service manager, and, in many cases, one or more additional assistant managers and/or key employees. The managing partner of each restaurant has primary responsibility for the day-to-day operations of the entire restaurant and is responsible for maintaining the standards of quality and performance established by us. We use market partners to supervise the operation of our restaurants including the continuing development of each restaurant's management team. Through regular visits to the restaurants, the market partners ensure adherence to all aspects of our concept, strategy and standards of quality. To further assure adherence to our standards of quality and to achieve uniform execution throughout the system, we employ product coaches who regularly visit the restaurants to assist in training of both new and existing employees and to grade food quality. The attentive service and high quality food, which results from each restaurant having a managing partner, two to three managers and the hands-on assistance of a product coach, are critical to our success.

Training and Development. All restaurant employees are required to complete varying degrees of training before and during employment. Our detailed training program emphasizes our operating strategy, procedures and standards and is conducted individually at Texas Roadhouse restaurants and in groups in Louisville, Kentucky.

Our managing and market partners are generally required to have significant experience in the full-service restaurant industry and are generally hired at a minimum four to 12 months before their placement in a new or existing restaurant to allow time to fully train in all aspects of restaurant operations. All managing partners, kitchen and service managers and other management team members are required to complete a comprehensive 16-week training program, which includes training for every position in the restaurant. Trainees are validated at pre-determined points during their training by either the market partner, product coach or a training manager.

A number of our restaurants have been certified as training centers by our training department. This certification confirms that the training center adheres to established operating procedures and guidelines. Additionally, most restaurants are staffed with training coordinators responsible for ongoing daily training needs.

For new restaurant openings, a full team of designated trainers, each specializing in a specific restaurant position, is deployed to the restaurant at least ten days before opening. Formal employee training begins seven days before opening, and follows a uniform, comprehensive training course as directed by a training manager.

Marketing

Our marketing strategy aims to promote the Texas Roadhouse brand, while retaining a localized focus, to:

increase comparable restaurant sales by attracting new guests to our restaurants and increase the frequency of visits by our current guests;

support new restaurant openings to achieve restaurant sales and operating margin goals; and

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communicate and promote the uniqueness, appeal, quality and consistency of our brand.

We accomplish these objectives through three major initiatives.

In-restaurant Marketing. A significant portion of our marketing fund is spent in communicating with our guests while they are in our restaurants through point of purchase materials. We believe special promotions such as Valentine's Day and Mother's Day drive significant repeat business. Also, our eight week holiday gift card campaign is one of our most significant promotions. In addition, our mascot, "Andy Armadillo®", provides our guests with a familiar and easily identifiable face.

Local Restaurant Area Marketing. Given our strategy to be a neighborhood destination, local area marketing is integral in developing brand awareness in each market. To enhance our visibility in new markets, we deliver free food to local businesses in connection with new restaurant openings. Managing partners are encouraged to participate in creative community-based marketing, such as hosting local radio or television programs. We also engage in a variety of promotional activities, such as contributing time, money and complimentary meals to charitable, civic and cultural programs. For instance, our involvement with the Special Olympics, a local Little League baseball team, a local church or the Armed Forces, shows our "Legendary Care, Concern and Support" for our communities. We leverage the corresponding recognition in our public relations and marketing efforts to communicate our corporate values and mission statement to our guests. We employ marketing coordinators at the restaurant and market level to develop and execute the majority of the local marketing strategies.

Advertising. Although our restaurant concept is not media driven, to build brand awareness we spend a limited amount of our marketing dollars on various advertising channels, including billboard, print, radio and television. These advertisements are designed to reflect "Legendary Food, Legendary Service®" as well as our fun and welcoming restaurant environment.

Restaurant Franchise Arrangements

Franchise Restaurants. As of December 25, 2007, we had 20 franchisees that operated 81 restaurants in 23 states. Franchise rights are granted for specific restaurants, and we do not grant any rights to develop a territory. Approximately 70% of our franchise restaurants are operated by eight franchisees. No franchisee operates more than 15 restaurants.

Our standard franchise agreement has a term of ten years with two renewal options for an additional five years each if certain conditions are satisfied. Our current form of franchise agreement requires the franchisee to pay a royalty fee of 4.0% of gross sales. The royalty fee varies depending on when the agreements were entered into and range from 2.0% of gross sales to the current 4.0% fee. "Gross sales" means the total selling price of all services and products related to the restaurant. Gross sales do not include:

employee discounts or other discounts;

tips or gratuities paid directly to employees by guests;

any federal, state, municipal or other sales, value added or retailer's excise taxes; or

adjustments for net returns on salable goods and discounts allowed to guests on sales.

Franchisees are currently required to pay 0.3% of gross sales to a national advertising and marketing fund for the development of advertising materials, system-wide promotions and related marketing efforts. We have the ability under our agreements to increase the required national advertising and marketing fund contribution up to 2.5% of gross sales. We may also charge a marketing fee of 0.5% of gross sales, which we may use for market research and to develop system-wide promotional and advertising materials. A franchisee's total required advertising contribution or spending will not be more than 3.0% of gross sales.

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A franchise agreement may be terminated if the franchisee defaults in the performance of any of its obligations under the franchise agreement, including its obligations to operate the restaurant in strict accordance with our standards and specifications. A franchise agreement may also be terminated if a franchisee dies, becomes disabled or becomes insolvent, fails to make its required payments, creates a threat to the public health or safety, ceases to operate the restaurant, or misuses the Texas Roadhouse trademarks.

Our standard franchise agreement gives us the right, but not the obligation, to compel a franchisee to transfer its assets to us in exchange for shares of our stock, or to convert its equity interests into shares of our stock. The amount of shares that a franchisee would receive is based on a formula that is included in the franchise agreement.

Franchise Compliance Assurance. We have instituted a comprehensive system to ensure compliance with our systems and standards, both during the development and operating of franchise restaurants. After a preliminary franchise agreement is signed, we actively work with and monitor our franchisees to ensure successful franchise operations as well as compliance with the Texas Roadhouse standards and procedures. During the restaurant development phase, we approve the selection of restaurant sites and make available copies of our prototype building plans to franchisees. During construction, we review the building for compliance with our standards. We provide training to the managing partner and up to three other managers of a franchisee's first restaurant. We also provide trainers for a period of 12 to 15 days to assist in the opening of every franchise restaurant. Finally, on an ongoing basis, we conduct reviews on all franchise restaurants to determine their level of effectiveness in executing our concept at a variety of operational levels. Our franchisees are required to follow the same standards and procedures regarding equipment, food purchases and food preparation as we maintain in our company restaurants. Reviews are conducted by seasoned operations teams, and focus on key areas including health, safety and execution proficiency.

To continuously improve our communications with franchisees and the consistency of the brand, we maintain a business development council that includes representatives of our franchisees, company operations personnel and vendors. The council's functions are advisory. Its members review and comment on proposed advertising campaigns and materials and budget expenditures.

Management Services. We provide management services to 18 of the franchise restaurants in which we or our founder have an ownership interest. Such management services include accounting, operational supervision, human resources, training, and food, beverage and equipment consulting for which we receive monthly fees of up to 2.5% of gross sales. We also make available to these restaurants certain legal services through outside sources on a pass-through cost basis. We also provide restaurant employees on a pass-through cost basis to three franchise restaurants in which we or our founder have an ownership interest. In addition, we receive a monthly fee from two franchise restaurants for providing payroll and accounting services.

Management Information Systems and Restaurant Reporting

All of our company restaurants use computerized management information systems, which are designed to improve operating efficiencies, provide restaurant and Support Center management with timely access to financial and operating data and reduce administrative time and expense. With our current information systems, we have the ability to generate reports showing daily, weekly and period-to-date numbers on a company-wide, regional or individual restaurant basis. Together, this enables us to closely monitor sales, food and beverage costs and labor and operating expenses at each of our restaurants. We have a number of reports that provide comparative information that enables both restaurant and Support Center management to supervise the financial and operational performance of our restaurants and to recognize and understand trends in the business. Our accounting department uses a standard, integrated system to prepare monthly profit and loss statements, which

provide a detailed analysis of sales and costs, and which are compared both to the restaurant-prepared reports and to prior periods. We have satellite technology at the restaurant level, which serves as a high-speed, secure communication link between the restaurants and our Support Center as well as our credit and gift card processor.

Competition

According to the National Restaurant Association, or NRA, restaurant industry sales in 2008 will represent approximately 4% of the United States' gross domestic product. The NRA also forecasts that restaurant industry sales will reach \$558 billion and will encompass approximately 945,000 restaurants.

Competition in the restaurant industry is intense. Texas Roadhouse restaurants compete with mid-priced, full-service, casual dining restaurants primarily on the basis of taste, quality and price of the food offered, service, atmosphere, location and overall dining experience. Our competitors include a large and diverse group of restaurants that range from independent local operators to well-capitalized national restaurant chains. Although we believe that we compete favorably with respect to each of the above factors, other restaurants operate with concepts that compete for the same casual dining guests as we do, with the number of casual dining restaurants emphasizing steaks increasing in recent years. We also compete with other restaurants and retail establishments for quality site locations and restaurant-level employees.

Trademarks

Our registered trademarks and service marks include, among others, the marks "Texas Roadhouse@" and our stylized logo. We have registered all of our marks with the United States Patent and Trademark Office. We have registered or have registrations pending for our most significant trademarks and service marks in 13 foreign jurisdictions including the European Union. To better protect our brand, we have also registered the Internet domain name "www.texasroadhouse.com." We believe that our trademarks, service marks, and other proprietary rights have significant value and are important to our brand-building efforts and the marketing of our restaurant concept.

Government Regulation

We are subject to a variety of federal, state and local laws. Each of our restaurants is subject to permitting, licensing and regulation by a number of government authorities relating to alcoholic beverage control, health, safety, sanitation, building and fire codes, and to compliance with the applicable zoning, land use and environmental laws and regulations. Difficulties in obtaining or failure to obtain required licenses or approvals could delay or prevent the development of a new restaurant in a particular area.

In 2007, the sale of alcoholic beverages accounted for 11.4% of our restaurant sales. Alcoholic beverage control regulations require each of our restaurants to apply to a state authority and, in certain locations, county or municipal authorities for a license that must be renewed annually and may be revoked or suspended for cause at any time. Alcoholic beverage control regulations affect numerous aspects of restaurant operations, including minimum age of patrons and employees, hours of operation, advertising, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages.

The failure of a restaurant to obtain or retain liquor or food service licenses would have a material adverse effect on the restaurant's operations. To reduce this risk, each company restaurant is operated in accordance with procedures intended to assure compliance with applicable codes and regulations.

We are subject in certain states to "dram shop" statutes, which generally provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served

alcoholic beverages to the intoxicated person. We carry liquor liability coverage as part of our existing comprehensive general liability insurance, as well as excess umbrella coverage of \$100.0 million per occurrence, with a \$10,000 deductible for the first \$25.0 million.

Our restaurant operations are also subject to federal and state laws governing such matters as the minimum hourly wage, minimum tipped wage, unemployment tax rates, sales tax and similar matters, over which we have no control. Significant numbers of our service, food preparation and other personnel are paid at rates related to the federal minimum wage (which currently is \$5.85 per hour) or federal tipped wage (which currently is \$2.13 per hour). In addition, numerous states in which we operate have passed legislation governing the applicable state minimum hourly and/or tipped wage. Further planned and unplanned increases in federal and/or state minimum hourly and tipped wages will increase our labor costs.

Seasonality

Our business is subject to minor seasonal fluctuations. Historically, sales in most of our restaurants have been higher during the winter and summer months of each year.

Employees

As of December 25, 2007, we employed approximately 23,000 people, of whom 287 were executive and administrative personnel, 893 were restaurant management personnel and the remainder were hourly restaurant personnel. Many of our hourly restaurant employees work part-time. None of our employees are covered by a collective bargaining agreement.

Executive Officers of the Company

Set forth below are the name, age, position and a brief account of the business experience of each of our executive officers:

| Name | Age | Position |
|-----------------|-----|--|
| W. Kent Taylor | 52 | Chairman of the Company, Director |
| G.J. Hart | 50 | President, Chief Executive Officer, Director |
| Steven L. Ortiz | 50 | Chief Operating Officer |
| Scott M. Colosi | 43 | Chief Financial Officer |
| Sheila C. Brown | 55 | General Counsel, Corporate Secretary |

W. Kent Taylor. Mr. Taylor is our founder and was, until the completion of our initial public offering, Chief Executive Officer. Upon the completion of the initial public offering, Mr. Taylor became Chairman of the Company, an executive position. Before his founding of our concept, Mr. Taylor founded and co-owned Buckhead Bar and Grill in Louisville, Kentucky. Mr. Taylor has over 20 years of experience in the restaurant industry.

G.J. Hart. Mr. Hart has served as our President since May 15, 2000. Upon the completion of the initial public offering, Mr. Hart became President and Chief Executive Officer. From October 1995 until May 2000, Mr. Hart was President of Al Copeland Investments in Metairie, Louisiana, a privately held business consisting of four restaurant concepts, hotels, gaming, entertainment and food processing operations. From June 1991 to September 1995, Mr. Hart was President of TriFoods International, Inc., a producer of prepared food products. Mr. Hart has over 25 years of experience in the food industry.

Steven L. Ortiz. Mr. Ortiz has served as our Executive Vice President of Operations since May 2001. Upon the completion of the initial public offering, Mr. Ortiz became Chief Operating Officer. Mr. Ortiz joined our company in 1996 as a Market Partner in which capacity he was responsible for developing and starting new Texas Roadhouse restaurants in Texas. From 1982 to 1996, Mr. Ortiz was

employed by Bennigan's Restaurants in various capacities, including General Manager, Area Director and Regional Vice President. Mr. Ortiz has over 20 years of experience in the restaurant industry.

Scott M. Colosi. Mr. Colosi has served as our Chief Financial Officer since September 2002. From 1992 until September 2002, Mr. Colosi was employed by YUM! Brands, Inc., owner of the A&W, KFC, Pizza Hut, Long John Silver's and Taco Bell brands. During this time, Mr. Colosi served in various financial positions and, immediately prior to joining us, was Director of Investor Relations. Mr. Colosi has 20 years of experience in the restaurant industry.

Sheila C. Brown. Ms. Brown has served as our General Counsel and Secretary since November 2001. From August 2000 to November 2001, Ms. Brown was our Director of Property Acquisition and, from September 1998 to August 2000, Development Coordinator, in which capacity Ms. Brown was responsible for our real estate development activities. Ms. Brown has over 20 years of experience in the restaurant industry.

Website Access To Reports

We make our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, available, free of charge on or through the Internet website, www.texasroadhouse.com, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

ITEM 1A. RISK FACTORS

From time to time in annual reports and oral statements, and in this Annual Report on Form 10-K, we present statements about future events and expectations that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are based on our beliefs, assumptions and expectations of our future financial and operating performance and growth plans, taking into account the information currently available to us. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the expectations of future results we express or imply in any forward-looking statements. Risks and uncertainties that could cause actual results to differ materially include, but are not limited to, those discussed below.

Risks Related to Our Business

If we fail to manage our growth effectively, it could harm our business.

Failure to manage our growth effectively could harm our business. We have grown significantly since our inception and intend to grow substantially in the future. Our existing restaurant management systems, financial and management controls and information systems may not be adequate to support our planned expansion. Our ability to manage our growth effectively will require us to continue to enhance these systems, procedures and controls and to locate, hire, train and retain management and operating personnel. We cannot assure you that we will be able to respond on a timely basis to all of the changing demands that our planned expansion will impose on management and on our existing infrastructure. If we are unable to manage our growth effectively, our business and operating results could be materially adversely impacted.

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You should not rely on past increases in our average unit volumes or our comparable restaurant sales as an indication of our future results of operations because they may fluctuate significantly.

A number of factors have historically affected, and will continue to affect, our average unit volumes and comparable restaurant sales, including, among other factors:

our ability to execute our business strategy effectively;

unusually strong initial sales performance by new restaurants;

competition;

weather and acts of God;

consumer trends;

introduction of new menu items; and

general regional and national economic conditions.

Our average unit volumes and comparable restaurant sales may not increase at rates achieved over the past several years. Changes in our average unit volumes and comparable restaurant sales could cause the price of our Class A common stock to fluctuate substantially.

Our growth strategy, which primarily depends on our ability to open new restaurants that are profitable, is subject to many factors, some of which are beyond our control.

Our objective is to grow our business and increase stockholder value by (1) expanding our base of company restaurants (and, to a lesser extent, franchise restaurants) that are profitable and (2) increasing sales and profits at existing restaurants. While both these methods of achieving our objective are important to us, historically the most significant means of achieving our objective has been through opening new restaurants and operating these restaurants on a profitable basis. We expect this to continue to be the case in the future.

We cannot assure you that we will be able to open new restaurants in accordance with our expansion plans. We have experienced delays in opening some of our restaurants in the past and may experience delays in the future. Delays or failures in opening new restaurants could materially adversely affect our growth strategy. One of our biggest challenges in executing our growth strategy is locating and securing an adequate supply of suitable new restaurant sites. Competition for suitable restaurant sites in our target markets is intense and we cannot assure you that we will be able to find sufficient suitable locations, or suitable purchase or lease terms, for our planned expansion in any future period. Our ability to open new restaurants will also depend on numerous other factors, some of which are beyond our control, including, but not limited to, the following:

our ability to hire, train and retain qualified operating personnel, especially market partners and managing partners;

the availability of construction materials and labor;

our ability to control construction and development costs of new restaurants;

our ability to secure required governmental approvals and permits in a timely manner, or at all;

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our ability to secure liquor licenses;

the cost and availability of capital to fund construction costs and pre-opening expenses; and

weather and acts of God.

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Once opened, we anticipate that our new restaurants will generally take several months to reach planned operating levels due to start-up inefficiencies typically associated with new restaurants. We cannot assure you that any restaurant we open will be profitable or obtain operating results similar to those of our existing restaurants. Our ability to operate new restaurants profitably will depend on numerous factors, including those discussed above impacting our average unit volumes and comparable restaurant sales, some of which are beyond our control, including, but not limited to, the following:

competition;

consumer acceptance of our restaurants in new domestic or international markets;

the ability of the market partner and the managing partner to execute our business strategy at the new restaurant;

general regional and national economic conditions;

changes in government regulation; and

road construction and other factors limiting access to the restaurant.

Our failure to successfully open new restaurants that are profitable in accordance with our growth strategy could harm our business and future prospects.

Our franchisees could take actions that could harm our business.

Our franchisees are contractually obligated to operate their restaurants in accordance with Texas Roadhouse standards. We also provide training and support to franchisees. However, franchisees are independent third parties that we do not control, and the franchisees own, operate and oversee the daily operations of their restaurants. As a result, the ultimate success and quality of any franchise restaurant rests with the franchisee. If franchisees do not successfully operate restaurants in a manner consistent with our standards, the Texas Roadhouse image and reputation could be harmed, which in turn could adversely affect our business and operating results.

Our quarterly operating results may fluctuate significantly and could fall below the expectations of securities analysts and investors due to a number of factors, some of which are beyond our control, resulting in a decline in our stock price.

Our quarterly operating results may fluctuate significantly because of several factors, including:

the timing of new restaurant openings and related expenses;

restaurant operating costs for our newly-opened restaurants, which are often materially greater during the first several months of operation than thereafter;

labor availability and costs for hourly and management personnel including mandated changes in federal and/or state minimum and tip wage rates or health benefits;

profitability of our restaurants, especially in new markets;

changes in interest rates;

increases and decreases in average unit volumes and comparable restaurant sales;

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impairment of long-lived assets, including goodwill, and any loss on restaurant closures;

general economic conditions, both nationally and locally;

negative publicity relating to the consumption of beef or other products we serve;

changes in consumer preferences and competitive conditions;

expansion to new domestic or international markets;

adverse weather conditions which impact guest traffic at our restaurants;

increases in infrastructure costs; and

fluctuations in commodity prices.

Our business is also subject to minor seasonal fluctuations. Historically, sales in most of our restaurants have been higher during the winter and summer months of each year. As a result, our quarterly operating results and comparable restaurant sales may fluctuate as a result of seasonality. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year and comparable restaurant sales for any particular future period may decrease. In the future, operating results may fall below the expectations of securities analysts and investors. In that event, the price of our Class A common stock would likely decrease.

If we lose the services of any of our key management personnel, our business could suffer.

Our future success significantly depends on the continued services and performance of our key management personnel, particularly G.J. Hart, our president and chief executive officer; Scott M. Colosi, our chief financial officer; Steven L. Ortiz, our chief operating officer; and W. Kent Taylor, our founder and chairman. Our future performance will depend on our ability to motivate and retain these and other key officers and managers, particularly market partners and managing partners. Competition for these employees is intense. The loss of the services of members of our senior management or other key officers or managers or the inability to attract additional qualified personnel as needed could materially harm our business.

Our failure or inability to enforce our trademarks or other proprietary rights could adversely affect our competitive position or the value of our brand.

We own certain common law trademark rights and a number of federal and international trademark and service mark registrations, including the Texas Roadhouse® name and logo, and proprietary rights relating to certain of our core menu offerings. We believe that our trademarks and other proprietary rights are important to our success and our competitive position. We, therefore, devote appropriate resources to the protection of our trademarks and proprietary rights. The protective actions that we take, however, may not be enough to prevent unauthorized usage or imitation by others, which could harm our image, brand or competitive position and, if we commence litigation to enforce our rights, cause us to incur significant legal fees. Our inability to register or protect our marks and other proprietary rights in foreign jurisdictions could adversely affect our competitive position in international markets.

We cannot assure you that third parties will not claim that our trademarks or menu offerings infringe upon their proprietary rights. Any such claim, whether or not it has merit, could be time-consuming, result in costly litigation, cause delays in introducing new menu items in the future or require us to enter into royalty or licensing agreements. As a result, any such claim could have a material adverse effect on our business, results of operations, financial condition or liquidity.

We may need additional capital in the future and it may not be available on acceptable terms.

The development of our business may require significant additional capital in the future to, among other things, fund our operations and growth strategy. We have historically relied upon bank financing and private sales of equity interests in certain restaurants to fund our operations. Going forward, we will continue to rely on bank financing and also may seek access to the debt and/or equity capital markets. There can be no assurance, however, that these sources of financing will be available on terms favorable to us, or at all. Our ability to obtain additional financing will be subject to a number of factors, including market conditions, our operating performance, investor sentiment and our ability to incur additional debt in compliance with agreements governing our outstanding debt. These factors may make the timing, amount, terms and conditions of additional financings unattractive to us. If we are unable to raise additional capital, our growth could be impeded.

Our existing credit facility limits our ability to incur additional debt.

The lenders' obligation to extend credit under the facility depends on our maintaining certain financial covenants, including a minimum consolidated fixed charge coverage ratio of 2.00 to 1.00 and a maximum consolidated leverage ratio of 3.00 to 1.00. If we are unable to maintain these ratios, we would be unable to obtain additional financing under this facility. The credit facility permits us to incur additional secured or unsecured indebtedness outside the facility, except for the incurrence of secured indebtedness that in the aggregate exceeds 20% of our consolidated tangible net worth or circumstances where the incurrence of secured or unsecured indebtedness would prevent us from complying with our financial covenants.

We have also entered into other loan agreements with other lenders to finance various restaurants which impose financial covenants that are less restrictive than those imposed by our existing credit facility. A default under these loan agreements could result in a default under our existing credit facility, which in turn would limit our ability to secure additional funds under that facility. As of December 25, 2007, we were in compliance with all of our lenders' covenants.

The acquisition of existing restaurants from our franchisees and licensees and other strategic transactions may have unanticipated consequences that could harm our business and our financial condition.

We have previously announced our intention to opportunistically acquire existing restaurants from our franchisees or licensees. Additionally, from time to time, we evaluate potential mergers, acquisitions, joint ventures or other strategic initiatives to acquire or develop additional concepts. To successfully execute any acquisition or development strategy, we will need to identify suitable acquisition or development candidates, negotiate acceptable acquisition or development terms and obtain appropriate financing. Any acquisition or future development that we pursue, whether or not successfully completed, may involve risks, including:

material adverse effects on our operating results, particularly in the fiscal quarters immediately following the acquisition as the acquired restaurants are integrated into our operations;

risks associated with entering into domestic or international markets or conducting operations where we have no or limited prior experience;

risks inherent in accurately assessing the value, future growth potential, strengths, weaknesses, contingent and other liabilities and potential profitability of acquisition candidates, and our ability to achieve projected economic and operating synergies; and

the diversion of management's attention from other business concerns.

Future acquisitions of existing restaurants from our franchisees or licensees or other strategic partners, which may be accomplished through a cash purchase transaction, the issuance of shares of our Class A common stock or a combination of both, could have a dilutive impact on holders of our Class A common stock, and result in the incurrence of debt and contingent liabilities and impairment charges related to goodwill and other tangible and intangible assets, any of which could harm our business and financial condition. The development of additional concepts and/or the entrance into international markets may not be as successful as our experience in the development of the Texas Roadhouse concept domestically. Development rates for newer brands may differ significantly as there is increased risk in the development of a new restaurant concept or system.

Approximately 20% of our company restaurants are located in Texas and, as a result, we are sensitive to economic and other trends and developments in that state.

As of December 25, 2007, we operated a total of 41 company restaurants in Texas. As a result, we are particularly susceptible to adverse trends and economic conditions in this state, including its labor market. In addition, given our geographic concentration in this state, negative publicity regarding any of our restaurants in Texas could have a material adverse effect on our business and operations, as could other occurrences in Texas such as local strikes, energy shortages or increases in energy prices, droughts, earthquakes, fires or other natural disasters.

Our expansion into new domestic and/or international markets may present increased risks due to our unfamiliarity with the area.

Some of our new restaurants will be located in areas where we have little or no meaningful experience. Those markets may have different competitive conditions, consumer tastes and discretionary spending patterns than our existing markets, which may cause our new restaurants to be less successful than restaurants in our existing markets. An additional risk of expanding into new markets is the lack of market awareness of the Texas Roadhouse® brand. Restaurants opened in new markets may open at lower average weekly sales volumes than restaurants opened in existing markets, and may have higher restaurant-level operating expense ratios than in existing markets. Sales at restaurants opened in new markets may take longer to reach average unit volumes, if at all, thereby affecting our overall profitability.

Risks Relating to the Food Service Industry

Our business is affected by changes in consumer preferences and discretionary spending.

Our success depends, in part, upon the popularity of our food products. Shifts in consumer preferences away from our restaurants or cuisine, particularly beef, would harm our business. Also, our success depends to a significant extent on discretionary consumer spending, which is influenced by general economic conditions and the availability of discretionary income. Accordingly, we may experience declines in sales during economic downturns or during periods of uncertainty. Any material decline in the amount of discretionary spending could have a material adverse effect on our business, results of operations, financial condition or liquidity.

Our success depends on our ability to compete with many food service businesses.

The restaurant industry is intensely competitive and we compete with many well-established food service companies on the basis of taste, quality and price of products offered, guest service, atmosphere, location and overall guest experience. Our competitors include a large and diverse group of restaurant chains and individual restaurants that range from independent local operators that have opened restaurants in various markets to well-capitalized national restaurant companies. Many of our competitors or potential competitors have substantially greater financial and other resources than we do, which may allow them to react to changes in pricing, marketing and the casual dining segment of the restaurant industry better than we can. As our competitors expand their operations, we expect competition to intensify. We also compete with other restaurant chains and other retail businesses for quality site locations and hourly employees.

Changes in food and supply costs could adversely affect our results of operations.

Our profitability depends in part on our ability to anticipate and react to changes in food and supply costs. Any increase in food prices, particularly proteins, could adversely affect our operating results. In addition, we are susceptible to increases in food costs as a result of factors beyond our control, such as weather conditions, food safety concerns, product recalls and government regulations.

We cannot predict whether we will be able to anticipate and react to changing food costs by adjusting our purchasing practices and menu prices, and a failure to do so could adversely affect our operating results. In addition, because we provide a moderately priced product, we may not seek to or be able to pass along price increases to our guests. Also, if we adjust pricing there is no assurance that we will realize the full benefit of any adjustment due to changes in our guests' menu item selections.

We currently purchase the majority of our beef from three of the largest beef suppliers in the country under annual contracts. If any of these vendors were unable to fulfill its obligations under its contracts, we could encounter supply shortages and incur higher costs to secure adequate supplies, either of which would harm our business.

The food service industry is affected by litigation and publicity concerning food quality, health and other issues, which can cause guests to avoid our restaurants and result in significant liabilities or litigation costs.

Food service businesses can be adversely affected by litigation and complaints from guests, consumer groups or government authorities resulting from food quality, illness, injury or other health concerns or operating issues stemming from one restaurant or a limited number of restaurants. Adverse publicity about these allegations may negatively affect us, regardless of whether the allegations are true, by discouraging guests from eating at our restaurants. We could also incur significant liabilities if a lawsuit or claim results in a decision against us or litigation costs regardless of the result.

Health concerns relating to the consumption of beef or other food products could affect consumer preferences and could negatively impact our results of operations.

Like other restaurant chains, consumer preferences could be affected by health concerns about the consumption of beef, the key ingredient in many of our menu items, or negative publicity concerning food quality, illness and injury generally. In recent years there has been negative publicity concerning e-coli, hepatitis A, "mad cow," "foot-and-mouth" disease and "bird flu." This negative publicity, as well as any other negative publicity concerning food products we serve, may adversely affect demand for our food and could result in a decrease in guest traffic to our restaurants. If we react to the negative publicity by changing our concept or our menu, we may lose guests who do not prefer the new concept or menu, and may not be able to attract sufficient new guests to produce the revenue needed to make our restaurants profitable. In addition, we may have different or additional competitors for our intended guests as a result of a change in our concept and may not be able to compete successfully against those competitors. A decrease in guest traffic to our restaurants as a result of these health concerns or negative publicity or as a result of a change in our menu or concept could materially harm our business.

Our business could be adversely affected by increased labor costs or labor shortages.

Labor is a primary component in the cost of operating our business. We devote significant resources to recruiting and training our managers and hourly employees. Increased labor costs due to competition, increased minimum and tip wage or employee benefits costs or otherwise, would adversely impact our operating expenses. Numerous states have enacted legislation resulting in tip and minimum wage increases as well as pre-determined future increases. We anticipate that additional legislation will be enacted in future periods. Our operating expenses will be adversely affected to the extent that we are not able to offset these costs. In addition, our success depends on our ability to attract, motivate and retain qualified employees, including restaurant managers and staff, to keep pace with our growth strategy. If we are unable to do so, our results of operations may be adversely affected.

We may not be able to obtain and maintain licenses and permits necessary to operate our restaurants and compliance with laws could adversely affect our operating results.

The restaurant industry is subject to various federal, state and local government regulations, including those relating to the sale of food and alcoholic beverages. Such regulations are subject to change from time to time. The failure to obtain and maintain these licenses, permits and approvals, including liquor licenses, could adversely affect our operating results. Difficulties or failure to obtain the required licenses and approvals could delay or result in our decision to cancel the opening of new restaurants. Local authorities may revoke, suspend or deny renewal of our liquor licenses if they determine that our conduct violates applicable regulations.

In addition to our having to comply with these licensing requirements, various federal and state labor laws govern our relationship with our employees and affect operating costs. These laws include minimum and tip wage requirements, overtime pay, unemployment tax rates, workers' compensation rates, citizenship requirements and sales taxes. A number of factors could adversely affect our operating results, including:

additional government-imposed increases in minimum and/or tipped wages, overtime pay, paid leaves of absence and mandated health benefits;

increased tax reporting and tax payment requirements for employees who receive gratuities;

a reduction in the number of states that allow gratuities to be credited toward minimum wage requirements; and

increased employee litigation including claims relating to the Fair Labor Standards Act.

The federal Americans with Disabilities Act prohibits discrimination on the basis of disability in public accommodations and employment. Although our restaurants are designed to be accessible to the disabled, we could be required to make modifications to our restaurants to provide service to, or make reasonable accommodations for disabled persons.

Complaints or litigation may hurt us.

Occasionally, our guests file complaints or lawsuits against us alleging that we are responsible for some illness or injury they suffered as a result of a visit to our restaurants, or that we have problems with food quality or operations. We are also subject to a variety of other claims arising in the ordinary course of our business, including personal injury claims, contract claims, claims from franchisees and claims alleging violations of federal and state laws regarding consumer, workplace and employment matters, discrimination and similar matters, or we could become subject to class action lawsuits related to these matters in the future. The restaurant industry has also been subject to a growing number of claims that the menus and actions of restaurant chains have led to the obesity of certain of their guests. In addition, we are subject to "dram shop" statutes. These statutes generally allow a person injured by an intoxicated person to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person. Some litigation against restaurant chains has resulted in significant judgments, including punitive damages, under dram shop statutes. Because a plaintiff may seek punitive damages, which may not be covered by insurance, this type of action could have an adverse impact on our financial condition and results of operations. Regardless of whether any claims against us are valid or whether we are liable, claims may be expensive to defend and may divert time and money away from our operations and hurt our performance. A judgment significantly in excess of our insurance coverage for any claims could materially adversely affect our business, results of operations, financial condition or liquidity. Further, adverse publicity resulting from these allegations may materially adversely affect us and our restaurants.

Our current insurance may not provide adequate levels of coverage against claims.

We currently maintain insurance customary for businesses of our size and type. However, there are types of losses we may incur that cannot be insured against or that we believe are not economically reasonable to insure. Such damages could have a material adverse effect on our business and results of operations. In addition, we self-insure a significant portion of expected losses under our workers compensation, general liability and property insurance programs. Unanticipated changes in the actuarial assumptions and management estimates underlying our reserves for these losses could result in materially different amounts of expense under these programs, which could have a material adverse effect on our financial condition, results of operations and liquidity.

Risks Related to Our Stock and Corporate Structure

Provisions in our charter documents and Delaware law may delay or prevent our acquisition by a third party.

Our certificate of incorporation and by-laws contain several provisions that may make it more difficult for a third party to acquire control of us without the approval of our Board of Directors. These provisions include, among other things, elimination of stockholder action by written consent, advance notice for raising business or making nominations at meetings and "blank check" preferred stock. Blank check preferred stock enables our Board of Directors, without approval of the Class A stockholders, to designate and issue additional series of preferred stock with such dividend, liquidation, conversion, voting or other rights, including the right to issue convertible securities with no limitations on conversion, as our Board of directors may determine. The issuance of blank check preferred stock may adversely affect the voting and other rights of the holders of our common stock as our Board of Directors may designate and issue preferred stock with terms that are senior to our common stock. These provisions may make it more difficult or expensive for a third party to acquire a majority of our outstanding common stock. These provisions also may delay, prevent or deter a merger, acquisition, tender offer, proxy contest or other transaction that might otherwise result in our stockholders receiving a premium over the market price for their Class A common stock.

The Delaware General Corporation Law prohibits us from engaging in "business combinations" with "interested shareholders" (with some exceptions) unless such transaction is approved in a prescribed manner. The existence of this provision could have an anti-takeover effect with respect to transactions not approved in advance by the Board of Directors, including discouraging attempts that might result in a premium over the market price for our Class A common stock.

There may be an adverse effect on the value of our Class A common stock due to the disparate voting rights of our Class A common stock and our Class B common stock.

The holders of our Class A common stock and Class B common stock generally have identical rights except that (1) on all matters to be voted on by stockholders, holders of our Class A common stock are entitled to one vote per share while holders of our Class B common stock are entitled to ten votes per share, and (2) holders of our Class A common stock are not entitled to vote on any alteration of the powers, preferences or special rights of the Class B common stock that would not adversely affect the holders of our Class A common stock. The difference in the voting rights of our Class A common stock and Class B common stock could adversely affect the value of the Class A common stock to the extent that any investor or potential future purchaser of our Class A common stock ascribes value to the superior voting rights of our Class B common stock.

Our founder and chairman controls our company and this control could inhibit potential changes of control.

As of February 15, 2008, our founder and chairman, W. Kent Taylor, beneficially owned all of our outstanding shares of Class B common stock and 13,411,716 shares of Class A common stock, representing approximately 54% of our voting power. As a result, Mr. Taylor has the ability to control our management and affairs and the outcome of all matters requiring stockholder approval, including the election and removal of our entire Board of Directors, and any merger, consolidation or sale of all or substantially all of our assets. The Class B common stock has ten votes per share, while Class A common stock has one vote per share. While this dual-class structure is in effect, Mr. Taylor is able to control all matters submitted to our stockholders even if in the future he were to own significantly less than 50% of the equity of our company. This concentrated control could discourage others from initiating any potential merger takeover or other change of control transaction that may otherwise be beneficial to our businesses. As a result, the market price of Class A common stock could be adversely affected.

Our founder and chairman controls our company and his interests may differ from your interests.

As a result of W. Kent Taylor's controlling interests in our company as described above, Mr. Taylor is able to exercise a controlling influence over our business and affairs and to unilaterally determine the outcome of any matter submitted to a vote of our stockholders. Mr. Taylor's interests in our company may differ from the interests of our other stockholders, and Mr. Taylor could take actions or make decisions that are not in the best interests of our stockholders.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

Properties

Our Support Center is located in Louisville, Kentucky. We occupy this facility under leases with Paragon Centre Holdings, LLC, a limited liability company in which we have a minority ownership position. As of December 25, 2007, we leased 64,506 square feet. Our leases expire between March 31, 2014 and December 31, 2020. We have rights to expand our leased space as additional space in the building becomes available. We have an option to renew the leases for an additional five years. Of the

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204 company restaurants in operation as of December 25, 2007, we owned 110 locations and leased 94 locations, as shown in the following table.

| State | Owned | Leased | Total |
|----------------|-------|--------|-------|
| Alabama | 3 | | 3 |
| Arizona | 5 | 2 | 7 |
| Arkansas | | 1 | 1 |
| Colorado | 7 | 4 | 11 |
| Connecticut | | 3 | 3 |
| Delaware | 1 | 1 | 2 |
| Florida | 1 | 1 | 2 |
| Georgia | 2 | | 2 |
| Idaho | 1 | 2 | 3 |
| Illinois | 2 | 4 | 6 |
| Indiana | 7 | 4 | 11 |
| Iowa | 2 | 3 | 5 |
| Kansas | 2 | | 2 |
| Kentucky | 4 | 2 | 6 |
| Louisiana | 1 | 4 | 5 |
| Maine | | 1 | 1 |
| Maryland | | 1 | 1 |
| Massachusetts | 1 | 4 | 5 |
| Michigan | 3 | 4 | 7 |
| Minnesota | 1 | | 1 |
| Mississippi | 1 | | 1 |
| Missouri | 2 | 1 | 3 |
| New Hampshire | 2 | | 2 |
| New Jersey | | 1 | 1 |
| New Mexico | 1 | 1 | 2 |
| New York | 2 | 2 | 4 |
| North Carolina | 4 | 7 | 11 |
| North Dakota | | 2 | 2 |
| Ohio | 10 | 4 | 14 |
| Oklahoma | 2 | 3 | 5 |
| Pennsylvania | 3 | 9 | 12 |
| Rhode Island | | 1 | 1 |
| South Dakota | 1 | | 1 |
| Texas | 31 | 10 | 41 |
| Utah | | 4 | 4 |
| Virginia | 3 | 4 | 7 |
| West Virginia | 1 | | 1 |
| Wisconsin | 3 | 4 | 7 |
| Wyoming | 1 | | 1 |
| Total | 110 | 94 | 204 |

Additional information concerning our properties and leasing arrangements is included in note 2(p) and note 7 to the Consolidated Financial Statements appearing in Part II, Item 8 of this Annual Report on Form 10-K.

ITEM 3 LEGAL PROCEEDINGS

Occasionally, we are a defendant in litigation arising in the ordinary course of our business, including "slip and fall" accidents, employment related claims and claims from guests or employees alleging illness, injury or food quality, health or operational concerns. None of these types of litigation, most of which are covered by insurance, has had a material effect on us and, as of the date of this report, we are not party to any litigation that we believe would have a material adverse effect on our business.

On March 26, 2007, a civil case styled as a class action complaint titled *Nicole M. Ehrheart v. Texas Roadhouse, Inc. and Does 1 through 10 ("Ehrheart")*, Case Number CA 07-54, was filed against us in the United States District Court for the Western District of Pennsylvania Erie Division. The case alleges liability under the Fair and Accurate Credit Transactions Act ("FACTA") based on the alleged practice of unlawfully including more information than is permitted on the electronically printed credit or debit card receipts provided to customers. The plaintiff seeks monetary damages, including statutory damages, punitive damages, costs and attorneys' fees, and a permanent injunction against the alleged unlawful practice. Statutory damages range from \$100 to \$1,000 for each willful violation. We have filed an answer to the complaint denying the material allegations of the complaint. Discovery has not yet begun, however, because various motions that will affect the venue in which the case is heard have not yet been resolved.

On July 20, 2007, a civil case styled as a class action complaint titled *Mario Aliano v. Texas Roadhouse Holdings LLC and Does 1-10 ("Aliano")*, Case Number 07cv4108, was filed against us in the United States District Court for the Northern District of Illinois Eastern Division. The case alleges liability under FACTA. The plaintiff seeks statutory damages of \$100 to \$1,000 per violation, attorney's fees, litigation expenses and costs. We have filed an answer to the complaint denying the material allegations of the complaint. Discovery has not yet begun, however, because various motions that will affect the venue in which the case is heard have not yet been resolved.

We believe we have meritorious defenses to the *Ehrheart* and *Aliano* claims, and we intend to vigorously defend against the claims, including the plaintiffs' efforts to certify a nationwide class action. We believe that neither case will have a material adverse effect on our business and our consolidated financial position, results of operations or cash flows. However, if either court both granted class action status and imposed statutory penalties, the resolution of the case would be likely to have a material adverse effect on our business and our consolidated financial position, results of operation and cash flows.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our Class A common stock is traded on the Nasdaq Global Select Market under the symbol TXRH. The quarterly high and low closing prices of our Class A common stock by quarter were as follows:

| | <u>High</u> | <u>Low</u> |
|-------------------------------------|-------------|------------|
| Year ended December 25, 2007 | | |
| First Quarter | \$ 16.02 | \$ 12.59 |
| Second Quarter | \$ 15.63 | \$ 12.60 |
| Third Quarter | \$ 13.85 | \$ 11.62 |
| Fourth Quarter | \$ 13.18 | \$ 10.64 |
| Year ended December 26, 2006 | | |
| First Quarter | \$ 16.90 | \$ 13.80 |
| Second Quarter | \$ 17.09 | \$ 12.66 |
| Third Quarter | \$ 13.84 | \$ 9.74 |
| Fourth Quarter | \$ 14.76 | \$ 12.28 |

The number of holders of record of our Class A common stock as of February 15, 2008 was 314. The number of holders of record of our Class B common stock as of February 15, 2008 was one. There is no established trading market for our Class B common stock.

We have never declared or paid cash dividends on our common stock. The declaration and payment of cash dividends on our common stock is at the discretion of our Board of Directors, and any decision to declare a dividend will be based on a number of factors, including, but not limited to, earnings, financial condition, applicable covenants under our credit facility and other contractual restrictions, or other factors deemed relevant.

As of December 25, 2007, shares of Class A common stock authorized for issuance under our equity compensation plan are summarized in the following table. The number of shares to be issued upon exercise includes 36,000 shares of restricted Class A common stock which have been issued but which are subject to forfeiture. The weighted-average option exercise price is for stock options only, as the restricted stock has no exercise price. See note 13 to the Consolidated Financial Statements for a description of the plan.

| Plan Category | Shares to Be Issued Upon Exercise | Weighted-Average Option Exercise Price | Shares Available for Future Grants |
|------------------------------------|--|---|---|
| Plan approved by stockholders | 7,392,978 | \$ 9.11 | 4,451,639 |
| Plans not approved by stockholders | | | |
| Total | 7,392,978 | \$ 9.11 | 4,451,639 |

Unregistered Sales of Equity Securities

There were no equity securities sold by the Company during the period covered by this Annual Report on Form 10-K that were not registered under the Securities Act of 1933, as amended.

Issuer Repurchases of Securities

During the year ended December 25, 2007, there were no repurchases made by us or on our behalf, or by any "affiliated purchaser," of shares of our Class A common stock.

On February 14, 2008, our Board of Directors approved a stock repurchase program under which we are authorized to repurchase up to \$25.0 million of our Class A common stock. Under this program we may repurchase outstanding shares from time to time in open market transactions during the two-year period ending February 14, 2010. The timing and the amount of any repurchases will be determined by our management under parameters established by our Board of Directors, based on its evaluation of our stock price, market conditions and other corporate considerations.

Stock Performance Graph

The following graph sets forth cumulative total return experienced by holders of the Company's Class A common stock compared to the cumulative total return of the Russell 3000 Restaurant Index and the Russell 3000 Index for the period ended December 24, 2007, the last trading day of our fiscal year. The graph assumes the values of the investment in our Class A common stock and each index was \$100 on October 5, 2004, the first trading day of our stock, and the reinvestment of all dividends paid during the period of the securities comprising the indices.

Note:

The stock performance shown on the graph below does not indicate future performance.

Comparison of Cumulative Total Return Since October 5, 2004

Among Texas Roadhouse, Inc., the Russell 3000 Index, and the Russell 3000 Restaurant Index

| | <u>10/5/04</u> | <u>12/28/04</u> | <u>12/27/05</u> | <u>12/26/06</u> | <u>12/24/07</u> |
|-------------------------|----------------|-----------------|-----------------|-----------------|-----------------|
| Texas Roadhouse, Inc. | \$ 100.00 | \$ 130.01 | \$ 140.96 | \$ 118.17 | \$ 100.80 |
| Russell 3000 | \$ 100.00 | \$ 107.80 | \$ 112.97 | \$ 127.54 | \$ 134.55 |
| Russell 3000 Restaurant | \$ 100.00 | \$ 118.55 | \$ 123.23 | \$ 142.81 | \$ 149.83 |

ITEM 6 SELECTED CONSOLIDATED FINANCIAL DATA

We derived the selected consolidated financial data as of and for the years 2007, 2006, 2005 and 2004 from our audited consolidated financial statements. The 2004 financial data give effect to the combination of our operations under Texas Roadhouse, Inc., a "C" corporation, and the closing of the Company's initial public offering, both of which occurred on October 8, 2004. The 2004 financial data also give effect to an income tax provision for the period after October 8, 2004 and include an adjustment to establish a deferred tax liability related to the \$5.0 million excess of the reported amounts of the Company's assets and liabilities over the tax basis of those assets and liabilities at October 8, 2004.

The selected consolidated financial data as of and for the year 2003 and from December 31, 2003 through October 8, 2004 were derived from our audited consolidated financial statements and present the consolidated operations of Texas Roadhouse Holdings LLC and its wholly-owned and majority-owned restaurants, Texas Roadhouse Development Corporation, Texas Roadhouse Management Corp., WKT Restaurant Corp., and nine franchise restaurants, all of which were entities under the common control of Mr. Taylor. The Company utilizes a 52 or 53 week accounting period that ends on the last Tuesday in December. The Company utilizes a 13 week accounting period for quarterly reporting purposes. Our historical results are not necessarily indicative of our results for any future period.

| | Fiscal Year | | | | |
|--|------------------|------------------|------------------|------------------|------------------|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| (in thousands, except per share data) | | | | | |
| Consolidated Statements of Income: | | | | | |
| Revenue: | | | | | |
| Restaurant sales | \$ 724,372 | \$ 586,557 | \$ 448,341 | \$ 354,190 | \$ 279,519 |
| Franchise royalties and fees | 10,717 | 10,574 | 10,443 | 8,821 | 6,934 |
| Total revenue | 735,089 | 597,131 | 458,784 | 363,011 | 286,453 |
| Income from operations(1) | 63,213 | 54,369 | 47,296 | 38,682 | 34,258 |
| Income before taxes | 60,501 | 53,390 | 46,614 | 28,860 | 23,143 |
| Provision for income taxes(2) | 21,176 | 19,381 | 16,292 | 7,159 | |
| Net income | \$ 39,325 | \$ 34,009 | \$ 30,322 | \$ 21,701 | \$ 23,143 |
| | | | | Pro forma | |
| Historical net income | | | | \$ 21,701 | \$ 23,143 |
| | | | | 7,869 | 8,379 |
| Pro forma provision for income taxes(3) | | | | 13,832 | 14,764 |
| Net income adjusted for pro forma provision for income taxes | | | | 8,869 | 8,379 |
| Net income per common share: | | | | | |
| Basic | \$ 0.53 | \$ 0.46 | \$ 0.44 | \$ 0.27 | \$ 0.31 |
| Diluted | \$ 0.51 | \$ 0.44 | \$ 0.42 | \$ 0.24 | \$ 0.30 |
| Weighted average shares outstanding(4): | | | | | |
| Basic | 74,611 | 73,876 | 68,677 | 51,890 | 46,880 |
| Diluted | 76,832 | 76,520 | 72,565 | 56,514 | 49,544 |

| | Fiscal Year | | | | |
|--|--------------|--------------|-------------|-------------|-------------|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| (\$ in thousands) | | | | | |
| Consolidated Balance Sheet Data: | | | | | |
| Total assets | \$ 546,029 | \$ 452,588 | \$ 312,593 | \$ 275,854 | \$ 148,193 |
| Long-term debt and obligations under capital leases, net of current maturities | 66,482 | 35,362 | 6,881 | 13,531 | 57,168 |
| Total liabilities | 176,264 | 132,209 | 80,367 | 101,944 | 104,606 |
| Minority interest | 2,384 | 1,305 | 651 | 699 | 5,685 |
| Total stockholders' equity(5) | 367,381 | 319,074 | 231,575 | 173,211 | 37,902 |
| Selected Operating Data: | | | | | |
| Company restaurants: | | | | | |
| Number open at end of period | 204 | 163 | 127 | 107 | 87 |
| Average unit volumes(6) | \$ 3,976 | \$ 3,967 | \$ 3,891 | \$ 3,679 | \$ 3,401 |
| Comparable restaurant sales growth(7) | 1.4% | 3.5% | 5.6% | 7.6% | 3.4% |
| Net cash provided by operating activities | \$ 76,567 | \$ 79,744 | \$ 64,384 | \$ 57,275 | \$ 42,158 |
| Net cash used in investing activities | \$ (134,532) | \$ (109,845) | \$ (61,021) | \$ (49,735) | \$ (26,524) |
| Net cash provided by (used in) financing activities | \$ 35,745 | \$ 34,898 | \$ (20,611) | \$ 32,967 | \$ (17,722) |

- (1) Effective December 28, 2005, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment* ("SFAS 123R"), and changed our method of accounting for share-based payments. See note 13 to the Consolidated Financial Statements.
- (2) Until October 8, 2004, we operated as a limited liability company and were taxed as a partnership. Accordingly, we paid no significant income taxes on our own behalf and there is no provision for income taxes prior to October 8, 2004 in our consolidated financial statements.
- Our results for the year ended December 28, 2004 include a cumulative net deferred income tax provision of \$5.0 million. As a result of our conversion from a nontaxable limited liability company to a taxable "C" corporation as of our October 8, 2004 initial public offering, and in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, we established the beginning balances in our deferred tax assets and liabilities. Our net deferred tax liabilities are comprised primarily of differences in depreciation which were previously expensed for income tax purposes, but had not yet been expensed for financial reporting purposes. Such amounts were required to be recognized through the income tax provision in the period of the change in our tax status.
- Our effective tax rate is determined based on estimates of pre-tax income, permanent differences and credits, and is reviewed quarterly to determine if actual results require modifying the effective tax rate. Our actual effective tax rate for 2007 was 35.0%, comprised of a combined state tax rate of 3.7% and effective federal rate of 31.3%. Our actual effective tax rate for 2006 was 36.3%, comprised of a combined state tax rate of 3.1% and an effective federal rate of 33.2%. Our actual effective tax rate for 2005 was 34.9%, comprised of a combined state tax rate of 3.1% and an effective federal rate of 31.8%. Our actual effective tax rate for October 8, 2004 through December 28, 2004 was 33.6%, excluding the \$5.0 million deferred tax charge discussed above, comprised of a combined state tax rate of 3.4% and an effective federal rate of 30.2%.
- (3) The pro forma provision for income taxes gives effect to our reorganization as a "C" corporation. The adjustment is based upon the information shown in the table below. The combined state tax rate is our estimate of the average state tax rate we would have incurred based on the mix and volume of business we do in the states and the relevant apportionment factors for those states.

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The combined federal and state tax rates shown below give effect to the deductibility of state taxes at the federal level and tip tax credits from 2003 through October 7, 2004.

| | <u>2004</u> | <u>2003</u> |
|---|-------------|-------------|
| Effective federal tax rate | 31.6% | 32.5% |
| Combined state tax rate | 3.3% | 3.7% |
| Combined effective federal and state tax rate | 34.9% | 36.2% |

- (4) See note 11 to the Consolidated Financial Statements.
- (5) See note 10 to the Consolidated Financial Statements.
- (6) Average unit volume represents the average annual restaurant sales for all company restaurants open for a full six months before the beginning of the period measured. For comparative purposes, average unit volume of company-owned restaurants for 2006 in the table above were adjusted to reflect the restaurant sales of the nine franchise restaurants acquired on June 27, 2007.
- (7) Comparable restaurant sales growth reflects the change in year-over-year sales for the comparable restaurant base. We define the comparable restaurant base to include those restaurants open for a full 18 months before the beginning of the later fiscal period.

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our Company

Texas Roadhouse is a growing, moderately priced, full-service restaurant chain. Our founder and chairman, W. Kent Taylor, started the business in 1993. Our mission statement is "Legendary Food, Legendary Service®." Our operating strategy is designed to position each of our restaurants as the local hometown destination for a broad segment of consumers seeking high-quality, affordable meals served with friendly, attentive service. The first Texas Roadhouse restaurant opened in Clarksville, Indiana in February 1993. As of December 25, 2007, there were 285 Texas Roadhouse restaurants operating in 44 states, including:

204 "company restaurants," of which 197 were wholly-owned and seven were majority-owned. The results of operations of company restaurants are included in our consolidated operating results. The portion of income attributable to minority interests in company restaurants that are not wholly-owned is reflected in the line item entitled "Minority interest" in our consolidated statements of income.

81 "franchise restaurants," of which 78 were franchise restaurants and three were license restaurants. We have a 5.0% to 10.0% ownership interest in 18 franchise restaurants. The income derived from our minority interests in these franchise restaurants is reported in the line item entitled "Equity income from investments in unconsolidated affiliates" in our consolidated statements of income. Additionally, we provide various management services to these franchise restaurants, as well as two additional franchise restaurants in which we have no ownership interest.

We have contractual arrangements which grant us the right to acquire at pre-determined valuation formulas (i) the remaining equity interests in five of the seven majority-owned company restaurants and (ii) 63 of the franchise restaurants.

Presentation of Financial and Operating Data

We operate on a fiscal year that ends on the last Tuesday in December. Fiscal years 2007, 2006 and 2005 were 52 weeks in length. Our quarters are 13 weeks in length. Fiscal year 2008 will be 53 weeks in length and, as such, the fourth quarter of fiscal year 2008 will be 14 weeks in length.

Public Offerings

In connection with our follow-on Class A common stock offering on July 5, 2005, we:

issued and sold 700,000 new shares of Class A common stock at \$17.38 per share, raising approximately \$11.0 million after underwriting discounts and transaction costs;

repaid \$4.0 million of indebtedness on our credit facility with the proceeds raised in the offering; and

used the remaining proceeds to fund development of new restaurants and for general corporate purposes.

Long-term Strategies to Grow Earnings Per Share

Our long-term strategies with respect to increasing net income and earnings per share include the following:

Expanding Our Restaurant Base. We will continue to evaluate opportunities to develop Texas Roadhouse restaurants in existing markets and new domestic or international markets. We will remain

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focused primarily on mid-sized markets where we believe there exists a significant demand for our restaurants because of population size, income levels and the presence of shopping and entertainment centers and a significant employment base. Restaurants that we owned and operated for the full six months before the beginning of 2007 generated average unit volumes of \$4.0 million for 2007. Our average cash investment to develop and open a new restaurant, including the cost of land and pre-opening expenses, is approximately \$3.5 million to \$4.5 million. When we lease the land, the total cash cost of developing our prototype restaurant is between \$2.5 million and \$3.5 million. Our ability to expand our restaurant base is influenced by factors beyond our control and therefore we may not be able to achieve our anticipated growth. See "Forward-looking Statements."

We may, at our discretion, add franchise restaurants, domestically and/or internationally, primarily with franchisees who have demonstrated prior success with the Texas Roadhouse or other restaurant concepts and in markets in which the franchisee demonstrates superior knowledge of the demographics and restaurant operating conditions. We may, also, look to acquire franchise restaurants under terms favorable to the Company and our stockholders. Additionally, from time to time, we may evaluate potential mergers, acquisitions, joint ventures or other strategic initiatives to acquire or develop additional concepts.

Maintaining and/or Improving Restaurant Level Profitability. We plan to maintain, or possibly increase, restaurant level profitability through a combination of increased comparable restaurant sales and operating cost management.

Leveraging Our Scalable Infrastructure. Over the past several years, we have made significant investments in our infrastructure, including information systems, real estate, human resources, legal, marketing and operations. As a result, we believe that our general and administrative costs will increase at a slower growth rate than our revenue.

Key Operating Personnel

Key personnel who have a significant impact on the performance of our restaurants include managing and market partners. Each company restaurant has one managing partner who serves as the general manager. Market partners can provide supervisory services for up to 12 to 15 managing partners and their respective management teams. Market partners also assist with our site selection process and recruitment of new management teams. The managing partner of each company restaurant and their corresponding market partners are required, as a condition of employment, to sign a multi-year employment agreement. The annual compensation of our managing and market partners includes a base salary plus a percentage of the pre-tax net income of the restaurant(s) they operate or supervise. Managing and market partners are eligible to participate in our equity incentive plan and are required to make deposits of \$25,000 and \$50,000, respectively, which can be used towards the payments of the exercise price of outstanding and vested stock options and/or the estimated tax liability due upon the vesting of any restricted stock unit award.

Key Measures We Use To Evaluate Our Company

Key measures we use to evaluate and assess our business include the following:

Number of Restaurant Openings. Number of restaurant openings reflects the number of restaurants opened during a particular fiscal period. For company restaurant openings we incur pre-opening costs, which are defined below, before the restaurant opens. Typically new restaurants open with an initial start-up period of higher than normalized sales volumes, which decrease to a steady level approximately three to six months after opening. However, although sales volumes are generally higher, so are initial costs, resulting in restaurant operating margins that are generally lower during the start-up period of operation and increase to a steady level approximately three to six months after opening.

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Comparable Restaurant Sales Growth. Comparable restaurant sales growth reflects the change in year-over-year sales for the comparable restaurant base. We define the comparable restaurant base to include those restaurants open for a full 18 months before the beginning of the later fiscal period. Comparable restaurant sales growth can be generated by an increase in guest traffic counts and/or by increases in the per person average check amount. Menu price changes and the mix of menu items sold can affect the per person average check amount.

Average Unit Volume. Average unit volume represents the average annual restaurant sales for all company restaurants open for a full six months before the beginning of the period measured. Growth in average unit volumes in excess of comparable restaurant sales growth is generally an indication that newer restaurants are operating with sales levels in excess of the company average. Conversely, growth in average unit volumes less than growth in comparable restaurant sales growth is generally an indication that newer restaurants are operating with sales levels lower than the company average.

Store Weeks. Store weeks represent the number of weeks that our company restaurants were open during the reporting period.

Other Key Definitions

Restaurant Sales. Restaurant sales include gross food and beverage sales, net of promotions and discounts.

Franchise Royalties and Fees. Franchisees typically pay a \$40,000 initial franchise fee for each new restaurant and a franchise renewal fee equal to the greater of 30% of the then-current initial franchise fee or \$10,000 to \$15,000. Franchise royalties consist of royalties in the amount of 2.0% to 4.0% of gross sales, as defined in our franchise agreement, paid to us by our franchisees.

Restaurant Cost of Sales. Restaurant cost of sales consists of food and beverage costs.

Restaurant Labor Expenses. Restaurant labor expenses include all direct and indirect labor costs incurred in operations except for profit sharing incentive compensation expenses earned by our managing and market partners. These profit sharing expenses are reflected in restaurant other operating expenses. Restaurant labor expenses also include share-based compensation expense related to restaurant-level employees.

Restaurant Rent Expense. Restaurant rent expense includes all rent associated with the leasing of operating real estate and includes base, percentage and straight-line rent expense.

Restaurant Other Operating Expenses. Restaurant other operating expenses consist of all other restaurant-level operating costs, the major components of which are utilities, supplies, advertising, repair and maintenance, property taxes, credit card fees and general liability insurance. Profit sharing allocations to managing partners and market partners are also included in restaurant other operating expenses.

Pre-opening Expenses. Pre-opening expenses, which are charged to operations as incurred, consist of expenses incurred before the opening of a new restaurant and are comprised principally of opening team and training salaries, travel expenses, rent, and food, beverage and other initial supplies and expenses.

Depreciation and Amortization Expenses. Depreciation and amortization expenses ("D&A") includes the depreciation of fixed assets and amortization of intangibles with definite lives.

Impairment costs. Impairment costs include any impairment of long-lived assets associated with restaurants where the carrying amount of the asset is not recoverable and exceeds the fair value of the asset.

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General and Administrative Expenses. General and administrative expenses ("G&A") are comprised of expenses associated with corporate and administrative functions that support development and restaurant operations and provide an infrastructure to support future growth. Supervision and accounting fees received from certain franchise restaurants and license restaurants are offset against G&A. G&A also includes share-based compensation expense related to executive officers, support center employees and market partners.

Interest Expense, Net. Interest expense includes the cost of our debt obligations including the amortization of loan fees, reduced by interest income and capitalized interest. Interest income includes earnings on cash and cash equivalents.

Minority Interest. Minority interest represents the portion of income attributable to the other owners of the majority-owned or controlled restaurants. Our consolidated subsidiaries at December 25, 2007 included eight majority-owned restaurants, seven of which were open and one of which was under construction. Our consolidated subsidiaries at December 26, 2006 included five majority-owned restaurants, all of which were open. Our consolidated subsidiaries at December 27, 2005 included four majority-owned restaurants, three of which were open.

Equity Income from Unconsolidated Affiliates. As of December 25, 2007 and December 26, 2006, we owned 5.0% to 10.0% equity interest in 18 franchise restaurants. At December 27, 2005, we owned 5% to 10% equity interest in 16 franchise restaurants. Also, at December 27, 2005, we also owned 1%

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equity interest in one franchise restaurant. Equity income from unconsolidated affiliates represents our percentage share of net income earned by these unconsolidated affiliates.

Results of Operations

| | Fiscal Year | | | | | |
|---|----------------|--------------|----------------|--------------|----------------|--------------|
| | 2007 | | 2006 | | 2005 | |
| | \$ | % | \$ | % | \$ | % |
| | (in thousands) | | | | | |
| Consolidated Statements of Income: | | | | | | |
| Revenue: | | | | | | |
| Restaurant sales | 724,372 | 98.5 | 586,557 | 98.2 | 448,341 | 97.7 |
| Franchise royalties and fees | 10,717 | 1.5 | 10,574 | 1.8 | 10,443 | 2.3 |
| Total revenue | 735,089 | 100.0 | 597,131 | 100.0 | 458,784 | 100.0 |
| Costs and expenses: | | | | | | |
| <i>(As a percentage of restaurant sales)</i> | | | | | | |
| Restaurant operating costs: | | | | | | |
| Cost of sales | 255,060 | 35.2 | 205,615 | 35.1 | 158,004 | 35.2 |
| Labor | 205,780 | 28.4 | 162,610 | 27.7 | 122,090 | 27.2 |
| Rent | 11,735 | 1.6 | 10,052 | 1.7 | 8,397 | 1.9 |
| Other operating | 116,258 | 16.0 | 95,536 | 16.3 | 75,106 | 16.8 |
| <i>(As a percentage of total revenue)</i> | | | | | | |
| Pre-opening | 12,741 | 1.7 | 12,508 | 2.1 | 8,092 | 1.8 |
| Depreciation and amortization | 30,446 | 4.1 | 21,357 | 3.6 | 14,582 | 3.2 |
| Impairment | 1,721 | 0.2 | 481 | 0.1 | | |
| General and administrative | 38,135 | 5.2 | 34,603 | 5.8 | 25,217 | 5.5 |
| Total costs and expenses | 671,876 | 91.4 | 542,762 | 90.9 | 411,488 | 89.7 |
| Income from operations | 63,213 | 8.6 | 54,369 | 9.1 | 47,296 | 10.3 |
| Interest expense, net | 2,295 | (0.3) | 645 | (0.1) | 263 | (0.1) |
| Minority interest | 711 | (0.1) | 585 | (0.1) | 549 | (0.1) |
| Equity income from investments in unconsolidated affiliates | (294) | 0.0 | (251) | 0.0 | (130) | 0.0 |
| Income before taxes | 60,501 | 8.2 | 53,390 | 8.9 | 46,614 | 10.2 |
| Provision for income taxes | 21,176 | 2.9 | 19,381 | 3.2 | 16,292 | 3.6 |
| Net income | 39,325 | 5.3 | 34,009 | 5.7 | 30,322 | 6.6 |

Restaurant Unit Activity

| | Company | Franchise | Total |
|------------------------------|----------------|------------------|--------------|
| | _____ | _____ | _____ |
| Balance at December 28, 2004 | 107 | 86 | 193 |
| Openings | 20 | 8 | 28 |
| Acquisitions (Dispositions) | | | |
| Closures | | | |
| | _____ | _____ | _____ |
| Balance at December 27, 2005 | 127 | 94 | 221 |
| Openings | 25 | 5 | 30 |
| Acquisitions (Dispositions) | 11 | (11) | |
| Closures | | | |
| | _____ | _____ | _____ |
| Balance at December 26, 2006 | 163 | 88 | 251 |
| Openings | 32 | 2 | 34 |
| Acquisitions (Dispositions) | 9 | (9) | |
| Closures | | | |
| | _____ | _____ | _____ |
| Balance at December 25, 2007 | 204 | 81 | 285 |
| | _____ | _____ | _____ |

Restaurant Sales

Restaurant sales increased by 23.5% in 2007 as compared to 2006. This increase was primarily attributable to the opening of new restaurants, the acquisitions of nine franchise restaurants on June 27, 2007 and comparable restaurant sales growth. Restaurant sales increased by 30.8% in 2006 as compared to 2005. This increase was primarily attributable to the opening of new restaurants, the acquisitions of 11 franchise restaurants on the first day of fiscal 2006 and comparable restaurant sales growth.

The following table summarizes certain key drivers and/or attributes of restaurant sales at company restaurants for the periods.

| | 2007 | 2006 | 2005 |
|-------------------------------------|--------------|--------------|--------------|
| | _____ | _____ | _____ |
| Company Restaurants | | | |
| Store weeks | 9,499 | 7,648 | 5,984 |
| Comparable restaurant sales growth | 1.4% | 3.5% | 5.6% |
| Average unit volumes (in thousands) | \$ 3,976 | \$ 3,967 | \$ 3,891 |

The 2007 amounts in the table above include the impact of increased menu pricing of approximately 0.8% implemented in October 2006 and approximately 2% implemented in phases starting in December 2006 through February 2007. The October 2006 menu price increase was principally driven by industry wide increases in commodity costs, while the most recent increase was principally driven by increases in minimum and tip wages which took effect in numerous states at the beginning of 2007. The 2006 amounts in the table above include the impact of increased menu pricing of approximately 1.0% and 0.8% implemented in January 2006 and October 2006, respectively. In January 2008 we increased menu prices by approximately 1.1% in response to continued inflationary pressures. We will continue to evaluate the need for and test further menu price increases as we assess the current inflationary environment.

On June 27, 2007, we acquired nine franchise restaurants. These acquisitions were slightly accretive to fiscal 2007 diluted earnings per share as we had only six months of operating results and we recorded a pre-tax, acquisition-related charge of \$0.5 million during the third quarter of fiscal 2007, in accordance with Emerging Issues Task Force ("EITF") Issue 04-1, *Accounting for Preexisting*

Relationships between the Parties to a Business Combination ("EITF 04-1") as discussed in note 3 to the Consolidated Financial Statements. On an on-going annual basis, we estimate these acquisitions will be accretive to diluted earnings per share by approximately \$0.015. In fiscal 2007, restaurant sales included \$16.4 million from the nine acquired franchise restaurants, as these restaurants were acquired at the beginning of third quarter of 2007. For comparative purposes, average unit volume for 2006 in the table above was adjusted to reflect restaurant sales of the nine acquired franchise restaurants as part of company-owned restaurants average unit volume.

On December 28, 2005, we acquired 11 franchise restaurants. These acquisitions were accretive to 2006 diluted earnings per share by approximately \$0.02 prior to any acquisition-related charges. We recorded a charge of \$0.8 million on the first quarter 2006 acquisitions as discussed in note 3 to the Consolidated Financial Statements.

In 2008, we plan to open approximately 30 additional company restaurants. We have either begun construction or have sites currently under contract for purchase or lease for all of these restaurants. In addition, we will continue to evaluate opportunities for acquiring additional franchise restaurants in 2008.

Franchise Royalties and Fees

Franchise royalties and fees increased by \$0.1 million, or by 1.4%, from 2006 to 2007. This increase was primarily attributable to the impact of the opening of new franchise restaurants in the latter half of fiscal 2006 and during fiscal 2007 and increasing royalty rates in conjunction with the renewal of certain franchise agreements, offset by the loss of royalties associated with the nine acquired franchise restaurants on June 27, 2007. These acquired franchise restaurants generated approximately \$0.6 million and \$1.1 million in franchise royalties in fiscal 2007 and fiscal 2006, respectively. Franchise comparable restaurant sales growth was 0.8% in 2007. Franchise restaurant count activity is shown in the restaurant unit activity table above. In 2008, we expect that our franchisees will open one to two new franchise restaurants.

Franchise royalties and fees increased by \$0.1 million, or by 1.3%, from 2005 to 2006. This increase was primarily attributable to the opening of new franchise restaurants and comparable restaurant sales growth of 2.7%, offset by the impact of our acquisitions of 11 franchise restaurants on December 28, 2005. These acquired franchise restaurants generated approximately \$1.3 million in franchise royalties in 2005. Franchise restaurant count activity is shown in the restaurant unit activity table above.

Restaurant Cost of Sales

Restaurant cost of sales, as a percentage of restaurant sales, increased to 35.2% in 2007 from 35.1% in 2006. This increase was primarily attributable to higher dairy and bread mix costs, partially offset by menu price increases discussed above. We expect to face continued inflationary pressures in commodity costs in 2008, which may or may not be offset by additional menu price adjustments.

Restaurant cost of sales, as a percentage of restaurant sales, decreased to 35.1% in 2006 from 35.2% in 2005. This decrease was primarily due to menu price increases discussed above, partially offset by higher commodity costs, principally produce costs.

Restaurant Labor Expenses

Restaurant labor expenses, as a percentage of restaurant sales, increased to 28.4% in 2007 from 27.7% in 2006. This increase was primarily attributable to higher average hourly wage rates resulting from several state-mandated increases in minimum and tip wage rates during 2007 and restaurants opened in fiscal 2007 as we generally incur higher labor costs during the first few months after the opening of a new restaurant, partially offset by the impact of menu price increases as discussed above and lower share-based compensation expense. We anticipate our labor costs will continue to be pressured by inflation, which is caused by federal and state-mandated increases in minimum and tip wage rates, among other things. These increases in costs may or may not be offset by additional menu price adjustments.

Restaurant labor expenses, as a percentage of restaurant sales, increased to 27.7% in 2006 from 27.2% in 2005. This increase was primarily due to the expensing of stock options in conjunction with the adoption of Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised 2004), *Share-Based Payment* ("SFAS 123R"), at the beginning of fiscal 2006, offset by a reduction in our workers' compensation insurance expense. We recorded share-based compensation expense of \$2.9 million (0.5% as a percentage of restaurant sales) in 2006, as discussed in note 2 to the Consolidated Financial Statements. Our workers' compensation insurance expense decreased 0.1% as a percentage of restaurant sales in 2006 due to more favorable claims experience. The remaining increase is primarily due to restaurants opened in 2006 as we generally incur higher labor costs during the first few months after the opening of a new restaurant, partially offset by the percentage of sales benefit generated from comparable restaurant sales growth.

Restaurant Rent Expense

Restaurant rent expense, as a percentage of restaurant sales, decreased to 1.6% in 2007 from 1.7% in 2006 which was a decrease from 1.9% in 2005. The slight decrease in 2007 was primarily due to the benefit generated from comparable restaurant sales growth, while the decrease in 2006 was due to the impact associated with the 11 acquired franchise restaurants (eight of the 11 acquired franchise restaurants are on owned properties) and the benefit generated from comparable restaurant sales growth.

Restaurant Other Operating Expenses

Restaurant other operating expenses, as a percentage of restaurant sales, decreased to 16.0% in 2007 from 16.3% in 2006. This decrease was primarily due to a decrease in equipment rent and lower managing and market partner bonuses, as a percentage of restaurant sales, partially offset by higher credit card fees and less favorable general liability insurance claims experience. Equipment rent decreased 0.3%, as a percentage of restaurant sales, in fiscal 2007 due to our discontinuance of leasing arrangements for restaurant equipment packages. Managing and market partner bonuses were lower, as a percentage of restaurant sales, due to lower profitability. The increase in credit card fees resulted from the increased use of credit and debit cards as a percentage of restaurant transactions. Our general liability claims experience for the policy year ended September 30, 2007, though favorable, was not as favorable as for the prior year policy period.

Restaurant other operating expenses, as a percentage of restaurant sales, decreased to 16.3% in 2006 from 16.8% in 2005. This decrease was primarily due to lower insurance costs, equipment rent, credit card fees and the sales benefit generated from comparable restaurant sales growth. General liability insurance expense decreased 0.1%, as a percentage of restaurant sales, due to more favorable claims experience, while credit cards fees were 0.1% lower, as a percentage of restaurant sales, than in 2005 due to a \$0.8 million pre-tax, non-cash charge to credit card fees in the third quarter of 2005 to recognize an accounting policy change. Additionally, equipment rent decreased 0.1%, as a percentage

of restaurant sales, due to us no longer utilizing leasing arrangements to finance equipment packages on new stores.

Restaurant Pre-opening Expenses

Pre-opening expenses in 2007 increased slightly to \$12.7 million from \$12.5 million in 2006. This increase was primarily due to seven more restaurants being opened in fiscal 2007 compared to fiscal 2006. Pre-opening costs will fluctuate from period to period based on the number and timing of restaurant openings and the number and timing of restaurant managers hired.

Pre-opening expenses in 2006 increased to \$12.5 million from \$8.1 million in 2005. This increase was primarily due to substantially more restaurants being in the development pipeline in fiscal 2006 versus fiscal 2005. Additionally, we opened 25 restaurants in fiscal 2006 compared to 20 restaurants in fiscal 2005. We incurred additional pre-opening expense in fiscal 2006 of \$0.4 million related to expensing rental costs associated with the construction of new restaurants as required by Staff Position FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period*, as discussed in note 2 to the Consolidated Financial Statements.

Depreciation and Amortization Expenses

D&A, as a percentage of revenue, increased to 4.1% in 2007 from 3.6% in 2006 which was an increase from 3.2% in 2005. This increase was primarily related to capital spending on new restaurants.

Impairments

Impairments increased in 2007 to \$1.7 million (0.2% of revenue) from \$0.5 million (0.1% of revenue) in 2006. No impairment costs were recorded in 2005. Impairment costs of \$1.7 million in 2007 were incurred in conjunction with our 2007 impairment analysis during which the carrying value of one underperforming restaurant was reduced to its estimated fair value. The impairment costs of \$0.5 million in 2006 were incurred in conjunction with the planned relocation of two restaurant sites in 2007. Prior to 2007, these costs were recorded in Other Operating Expenses.

General and Administrative Expenses

G&A decreased in 2007 to 5.2% of revenue from 5.8% of revenue in 2006. This decrease was primarily due to leveraging of the base business and lower share-based compensation costs.

G&A increased in 2006 to 5.8% of revenue from 5.5% of revenue in 2005. This increase was primarily due to the adoption of SFAS 123R and the application of EITF 04-1, offset by the leveraging of other G&A costs as our system continues to grow. In 2006, we recorded share-based compensation expense of \$3.3 million (0.5% of revenue) in conjunction with the adoption of SFAS 123R, as discussed in note 2 to the Consolidated Financial Statements, and a charge of \$0.8 million (0.1% of revenue) in conjunction with the application of EITF 04-1 relating to the acquisition of the 11 franchise restaurants in the first quarter of 2006, as discussed in note 3 to the Consolidated Financial Statements.

Interest Expense, Net

Net interest expense increased to \$2.3 million in 2007 from \$0.6 million in 2006. This increase was primarily due to increased borrowings under our credit facility, partially offset by an increase in interest income, the payoff of certain installment loans in the first quarter of fiscal 2006 and the prepayment penalties of \$0.1 million associated with these loans. The increased borrowings under our credit facility primarily resulted from the acquisitions of nine franchise restaurants on June 27, 2007.

Net interest expense increased to \$0.6 million in 2006 from \$0.3 million in 2005. Interest expense in 2005 included interest income of \$0.6 million. This increase was primarily due to increased

borrowings under our credit facility, offset by increased capitalized interest. Borrowings under our credit facility increased as a result of us acquiring the land and buildings leased by eight of the 11 franchise restaurants acquired on December 28, 2005 and increased capital expenditures relating to new restaurants.

Income Taxes

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Our effective tax rate for 2007 decreased to 35.0% from 36.3% in 2006. This decrease in the rate was primarily due to higher tax credits, the non-deductibility of a \$0.8 million charge related to franchise acquisitions in the first quarter of fiscal 2006 and a decrease in the non-deductible portion of certain incentive stock options relating to share-based compensation costs, partially offset by an increase in state income tax rates. We expect the effective tax rate to be approximately 35.0% for fiscal 2008.

Our effective tax rate for 2006 increased to 36.3% from 34.9% in 2005. This increase was due to the non-deductibility of certain incentive stock options in accordance with SFAS 123R and the charge relating to the application of EITF 04-1, partially offset by higher federal tax credits.

Liquidity and Capital Resources

The following table presents a summary of our net cash provided by (used in) operating, investing and financing activities:

| | Fiscal Year | | |
|---|----------------|-----------|-------------|
| | 2007 | 2006 | 2005 |
| | (in thousands) | | |
| Net cash provided by operating activities | \$ 76,567 | \$ 79,744 | \$ 64,384 |
| Net cash used in investing activities | (134,532) | (109,845) | (61,021) |
| Net cash provided by (used in) financing activities | 35,745 | 34,898 | (20,611) |
| Net (decrease) increase in cash | \$ (22,220) | \$ 4,797 | \$ (17,248) |

Net cash provided by operating activities was \$76.6 million in 2007 which was lower than \$79.7 million in 2006 primarily due to a \$9.5 million increase in accounts receivable due to the timing of credit card settlements as fiscal year 2007 ended on a bank holiday. Additionally, increases in other liabilities and income taxes payable were partially offset by higher net income and depreciation. Our operations have not required significant working capital and, like many restaurant companies, we have been able to operate with negative working capital. Sales are primarily for cash, and restaurant operations do not require significant inventories or receivables. In addition, we received trade credit for the purchase of food, beverages and supplies, thereby reducing the need for incremental working capital to support growth. Net cash provided by operating activities was \$79.7 million in 2006 compared to \$64.4 million in 2005. This increase was driven by changes in net income, depreciation and amortization and share-based compensation expense.

Net cash used in investing activities was \$134.5 million in 2007 compared to \$109.8 million in 2006. This increase was primarily due to the \$33.2 million use of cash associated with the acquisitions of the nine franchise restaurants in the third quarter of 2007, as compared to the \$13.3 million use of cash associated with acquisitions in 2006, and an increase in capital spending associated with new restaurant development. The \$33.2 million use of cash included \$22.8 million of cash paid in consideration of the nine franchise restaurants and \$12.1 million for the acquisitions of land and buildings previously leased by seven of the nine franchise restaurants acquired on the same date, offset by \$1.4 million of acquired cash from the franchise restaurants and \$0.5 million related to the application of EITF 04-1. N